COUNCIL AGENDA: 11-18-08
ITEM: 4.2

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Leslye Krutko
Jennifer A. Maguire

SUBJECT: **SEE BELOW**

DATE: October 27, 2008

Approved

Date 11-5-08

COUNCIL DISTRICT: Citywide
SNI AREA: N/A

SUBJECT: AUTHORIZATION FOR THE HOUSING DEPARTMENT TO ACCEPT FEDERAL FUNDS UNDER THE HOUSING AND ECONOMIC RECOVERY ACT OF 2008 AND APPROPRIATION OF THOSE FUNDS FOR ELIGIBLE ACTIVITIES

RECOMMENDATION

A. It is recommended that the City Council adopt a resolution authorizing:

1. The Director of Housing to accept federal Neighborhood Stabilization Program funds in the amount of $5,628,283,
2. A shortened citizen participation comment period of 15 days on a Substantial Amendment to the City's FY 2008-09 Consolidated Annual Action Plan (ConPlan),
3. Approval of a Substantial Amendment to the ConPlan, and
4. The Director of Housing to apply for and accept additional Neighborhood Stabilization Program funds from the State's allocation of $145 million.

B. It is recommended that the City Council adopt the following Appropriation Ordinance and Funding Sources Resolution amendments in the Multi-Source Housing Fund (Fund 448):

1. Establish an appropriation to the Housing Department for the Housing and Economic Recovery Act Program in the amount of $5,628,283,
2. Increase the estimate for Earned Revenue by $5,628,283.

OUTCOME

Acceptance of federal Neighborhood Stabilization Program funds under the 2008 Housing and Economic Recovery Act will help the City to mitigate blight caused by foreclosed properties. Whenever practicable, the City will purchase foreclosed multi-family housing for rehabilitation,

or demolish and redevelop multi-family projects to provide future affordable rental housing to lower-income households. Purchased property may also be placed in a "land bank" for future development in support of lower-income neighborhoods. Funds may also be utilized to purchase and rehabilitate foreclosed homes, which will then be sold to low- or moderate-income households with second-mortgage assistance.

BACKGROUND

The Housing and Economic Recovery Act of 2008 (HERA), signed by the President on July 30, 2008, appropriated $3.92 billion in funds for the Neighborhood Stabilization Program (NSP). Also known as the Foreclosure Relief Act, HERA, modeled after the Community Development Block Grant Program, addresses the national crisis of skyrocketing home foreclosures. Although staff originally anticipated that these funds could be used to assist homeowners to avoid foreclosure and stay in their homes, the NSP funds cannot be used for this purpose. Rather, the NSP is a blight mitigation program and funds must be used to reoccupy, purchase, and/or rehabilitate vacant, foreclosed homes.

Santa Clara County experienced a 70 percent increase in the number of mortgage defaults in the third quarter of 2008 over the same period last year, with the City of San José one of the main contributors to the regional increase. While the most recent two quarters in 2008 show a 25 percent regional decline in defaults, this is primarily attributable to a newly passed State law requiring lenders to contact delinquent homeowners 30 days in advance of filing a default notice. This law delays the default status on paper but does not eliminate the underlying issue that homeowners are still behind in their mortgage payments. Eventually, many of these homes will still be subject to foreclosure.

In addition to applying for NSP funds, the City of San Jose has taken a number of actions to respond to the foreclosure crisis, as was detailed in an information memo to the City Council dated August 28, 2008. We continue to pursue a number of actions and are considering new outreach efforts with neighborhoods that have been particularly hard-hit by this crisis.

Funding Allocations

San José will receive $5,628,283 in NSP funds based upon the following HUD allotment methodology:

The HUD allotment methodology is as follows:

- 70% of the funds are based on the number and percent of foreclosures,
- 15% of the funds are based on the number and percent of subprime loans,
- 10% of the funds are based on the number and percent of loans in default, and
- 5% of the funds are based upon the number and percent of delinquent loans.

The greater weight placed on foreclosures is based on the emphasis the statute places on targeting foreclosed homes. A portion of the funds are allocated directly to local governments with significant foreclosure activity; the largest portion is allocated to the State for competitive award.

HUD research has identified the California foreclosure rate to be 6.7% and the San Jose foreclosure rate to be 4%. Based upon the HUD calculations, the City of San Jose will receive a direct allocation of $5,628,283. In comparison, Stockton, with a 12.3% foreclosure rate, was awarded $12,146,038; and Oakland, with an 8.1% foreclosure rate, was awarded $8,250,668. San Francisco, Santa Clara County and other local jurisdictions were not deemed eligible to receive direct NSP allocations from HUD, but may be eligible to apply for funds awarded to the State.

Program regulations allow states receiving NSP allocations to distribute funds to any jurisdiction within the state that has the greatest need, even if the jurisdiction has received a direct formula allocation of funds from HUD. The State of California has been awarded $145 million, and the City of San José is eligible to apply for a portion of those funds. The City has already begun to coordinate with other Santa Clara County cities to develop a joint program and apply to the State for additional NSP funds.

Use of Funds

By statute, NSP funds may only be used to:

- Establish financing mechanisms for purchase and redevelopment of foreclosed homes
- Purchase and rehabilitate properties that have been abandoned or foreclosed in order to sell or rent them
- Establish land banks of homes that have been foreclosed
- Demolish blighted structures
- Redevelop demolished or vacant properties.

At least 25% of the funds ($1,407,071) must be set aside for activities that benefit very low-income (VLI) households (i.e. those earning no more than 50% of area median income.) The remaining funds may be used to assist moderate-income households (those with incomes up to 120% of area median income). Up to 10% of the funds may be used to administer the program.

At their discretion, localities may elect to use more than 25% of NSP funds for VLI households. Conversely, localities that are unable to utilize all of the 25% earmarked for VLI households will have those unutilized VLI funds returned to the State.

NSP has a five-year reinvestment period. This means that during the first five years, revenue generated from the sale, rental, redevelopment, or rehabilitation of properties financed through NSP may be used by the state or local government to further assist in the redevelopment of abandoned and foreclosed homes. After five years, any revenue generated would be returned to the U. S. Treasury unless HUD agrees to another use of the funds consistent with the Act's purposes.

Utilization of this new resource will help the broader community by mitigating blight in our neighborhoods, in addition to the benefits directly received by individual households through homebuyer assistance or affordable rental housing. Enterprise Community Partners has estimated that California localities can expect to see a direct return in property taxes (since in many cases, banks will not pay taxes on properties they do not expect to sell), savings on trash collection, police, and fire services that they must otherwise expend on foreclosed and abandoned properties, and property tax revenues that will be retained from properties no longer at risk of significant declines from being in close proximity to foreclosed and abandoned houses.

Foreclosure Assistance to Homeowners

Although by statute, none of the NSP funds may be used for foreclosure prevention assistance to homeowners still living in their homes, another part of the HERA legislation, the "Hope for Homeowners" program, will authorize the Federal Housing Administration (FHA) to refinance up $300 billion in mortgages of at-risk borrowers who can afford to make a reduced loan payment. The program will be in effect from October 1, 2008 through September 30, 2011.

Although the City is not eligible to apply for the Hope for Homeowner funds, City resources have been and will continue to be utilized to provide outreach and education to the community on resources available to at-risk homeowners. In October, City staff conducted three presentations in SNI areas particularly hard hit by foreclosures. Information was provided on a variety of resources available to households at risk for foreclosure.

In addition, the City is partnering with Neighborhood Housing Services of Silicon Valley (NHSSV) to increase outreach to the community on foreclosure issues. With the assistance of City funds, NHSSV has hired a foreclosure counselor to provide direct assistance to homeowners who are in, or who are at risk for entering, the foreclosure process.

The Housing Department also coordinated with housing organizations to hold a foreclosure prevention and resource fair on August 20, 2008, at Independence High School. The event brought together many foreclosure resources in one location for City of San José residents in the foreclosure process or who knew they were in danger of defaulting on their loans. Services included free foreclosure education, counseling, loan document review, and on-site loan modifications, and potentially other resources like legal and tax advice. Key partners include NHSSV, Project Sentinel, Don't Borrow Trouble Silicon Valley, California Association of Mortgage Brokers, Santa Clara County Association of Realtors, Bay Area Legal Aid, and Council on Aging Silicon Valley. Lenders available to perform loan modifications included Washington Mutual, Countrywide, Wells Fargo, IndyMac and GMAC. A second foreclosure prevention and resource fair is planned for February 2009.

In early 2009, the Housing Department will be bringing an informational memo to the City Council on the status of the foreclosure crisis in San José, and the efforts to assist individual homeowners.

ANALYSIS

HERA legislation provides an extremely tight timeframe for response. The bill required HUD to develop program requirements and funding disbursement mechanisms within 60 days of the President's signature. On September 29, 2008, HUD published the list of award allocations and the regulations for the NSP. The award allocations are not entitlements-- to qualify to receive the funds, localities must submit full descriptions of their proposed NSP programs to HUD no later than December 1, 2008. This submission takes the form of an amendment to the Consolidated Annual Action Plan, the annual plan that describes the City's plan for use of all of its HUD funds.

Basic NSP requirements

The NSP program carries strict requirements, which significantly limit the City's flexibility in developing programs to utilize the funds.

1. Households served cannot have incomes that exceed 120% of Area Median Income
2. At least 25% of the funds must be earmarked for households with incomes at or below 50% of Area Median Income.
3. All properties purchased with NSP funds must be foreclosed-upon homes or residential properties, or those that have been abandoned for at least 90 days.
4. All properties purchased with NSP funds must be acquired at an aggregate 15% discount below the current appraised market value.
5. All NSP funds must be obligated within 18 months of the award.
6. All NSP funds must be expended within four years of the award.

The Housing Department has researched the foreclosure market in San Jose and the parameters of the NSP funds, and developed two programs to best utilize this funding source.

Priority #1: Rental Housing Development-- Some San Jose neighborhoods, especially in SNI areas, have experienced significantly more foreclosures than the rest of the City. This has compounded the pre-existing economic challenges faced by those neighborhoods. To maximize the impact of the limited NSP funds, the Housing Department will focus this resource on those highly-impacted neighborhoods.

A key strategy will be the purchase of properties in highly impacted neighborhoods, especially four-plex properties. As an example, the Santee neighborhood has a large number of four-plexes, many of which are already under foreclosure. At the height of the market, these four-plexes were selling for over $900,000. The current market value is approximately $500,000 to $700,000. Most of these properties are still occupied. Depending on whether it was possible to aggregate contiguous properties, the Housing Department would either seek to rehabilitate the four-plexes, or demolish and rebuild.

Although the Housing Department's goal is to acquire and redevelop as many parcels as possible in one neighborhood, the limited availability of suitable properties may make it impossible to use all of the NSP funds in this program. The Department's second priority for NSP funds will be to assist lower-income households to acquire single-family homes.

Priority #2: Acquisition/Rehabilitation Program--As a second priority, the City would acquire single-family homes in foreclosure, rehabilitate them to mitigate any damage due to deferred maintenance or vandalism, and sell them at an affordable price to income-qualified households.

NSP requires that properties be purchased at a discount of at least 15% below the current appraised market value. It may be difficult to negotiate this discount, as banks have already sustained significant losses through the foreclosure process and are unlikely to agree to further discounts on individual purchases. Therefore, the Housing Department would seek to purchase a portfolio of foreclosed homes from one or more lenders, using the incentive of relieving the bank(s) of a number of properties in one transaction to negotiate the required 15% discount.

Use of Nonprofit Housing Organizations

In order to expedite the process of acquiring, repairing, and reselling properties, the Housing Department will explore the possibility of entering into an agreement with a nonprofit housing corporation or another organization that can act as the City's agent in acquiring, maintaining, and/or reselling the properties at a negotiated fee structure. The use of an intermediary is expected to help streamline and expedite the acquisition and resale process.

Administration

NSP regulation allow up to 10% of the funds to be used to by the jurisdiction to administer the program. These funds will offset the staff costs to manage the programs and track the expenditures and revenues. At this time, it is anticipated that the Housing Department has the capacity to absorb the increased workload associated with this program. In addition to the 10% for administration, legislation allows for reimbursement of program activity costs incurred after September 29, 2008, related to the Programs' early development and implementation efforts.

EVALUATION AND FOLLOW-UP

Program performance will be reported to the City Council in the Consolidated Annual Performance Evaluation Report, which reports the outcome of all City HUD-funded programs at the end of each fiscal year.

POLICY ALTERNATIVES

Alternative #1: *Do not accept federal funds under HR3221.*

Pros: Funds are one-time only and thus provide no ongoing assistance to the community. Implementation of the Program will result in increased workload.
Cons: Choosing not to accept NSP funds would mean the loss of federal funding to mitigate blight caused by foreclosed and vacant homes. Foreclosed properties create blight and result in increased code enforcement demand; the City needs to use all resources at its disposal to reduce the impact on our neighborhoods.
Reason for not recommending: Although limited, NSP funds will help stabilize neighborhoods impacted by home foreclosures, mitigate the risk of blight in San Jose neighborhoods, increase the city's supply of affordable housing, and provide valuable assistance to households in buying their first homes.

PUBLIC OUTREACH/INTEREST

☐ **Criterion 1:** Requires Council action on the use of public funds equal to $1 million or greater. **(Required: Website Posting)**

☑ **Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**

☐ **Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

In addition to website posting, public notice of this item was published on November 3, 2008, and public discussion was held at the November 13, 2008 meeting of the Housing and Community Development Commission.

COORDINATION

This memorandum was coordinated with the City Manager's Budget Office and the City Attorney's Office.

FISCAL/POLICY ALIGNMENT

This expenditure is consistent with the most recent Council-adopted Five Year Housing Investment Plan for FY 2007/2008 through FY 2011/2012, which sets forth a goal of constructing 2,250 affordable rental units and providing at least 553 new low- and moderate-income homebuyers with down payment assistance during the five-year period. Utilization of this new, temporary funding source is also in alignment with the strategy of aggressively seeking funds from local, State, and federal sources as described in the FY 2008-09 Consolidated Annual Action Plan.

COST SUMMARY/IMPLICATIONS

1. AMOUNT OF RECOMMENDATION/COST OF PROJECT: $5,628,283

2. COST ELEMENTS OF AGREEMENT/CONTRACT:

Direct Program Costs	$3,658,385
Minimum 25% VLI Set-Aside	$1,407,070
Administration	$562,828
Total Costs	$5,628,283

3. SOURCE OF FUNDING: One-time grant from the United States Department of Housing and Urban Development.

4. FISCAL IMPACT: No ongoing fiscal impact.

CEQA

Not a project.

LESLYE KRUTKO
Director of Housing

for
JENNIFER A. MAGUIRE
Budget Director

I hereby certify that there will be available for appropriation in the Multi-Source Housing Fund in the Fiscal Year 2008-2009 monies in excess of those heretofore appropriated therefrom, said excess being at least $5,628,823.

for
JENNIFER A. MAGUIRE
Budget Director

For more information, call LESLYE KRUTKO, DIRECTOR OF HOUSING, at (408) 535-3851.